

Attention Investment Advisers: Plain English Brochure Rule Adopted

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On July 21, 2010, the same day the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law, the SEC quietly released the long-anticipated new Form ADV, Part 2, otherwise known as the registered investment adviser brochure.

Background

Registered investment advisers are required to make certain disclosures to their clients. Historically they could do so by either preparing a glossy brochure containing the required information, or alternatively by simply delivering to their clients and prospective clients a copy of the Form ADV Part 2 which was a required paper filing with the SEC from 1979 until 2000. In 2000 the SEC adopted an electronic filing system for investment advisers known as IARD ("Investment Adviser Registration Depository"). The IARD system included an online version of Form ADV Part 1 but not Part 2. Advisers were instructed to continue using the old Part 2 paper format for client disclosure purposes, but the requirement to file Part 2 with the SEC was waived until an electronic version could be developed.

At about the same time in 2000, the SEC issued a release proposing the new Part 2 format and requesting comments. The comment period passed and nothing happened; the SEC appeared to lose interest in the matter until 2008, when they issued a revised proposed new Part 2 and requested more comments. Finally, a mere ten years after first raising the issue, they have completed work on the new Form ADV Part 2.

The New Part 2

The old Part 2 was a fill-in-the-blanks form, with numerous check boxes and yes or no questions, with supplemental sheets at the back of the document for elaboration on the answers given in the questionnaire portion of the document. It was not a particularly user-friendly document.

The new Part 2 takes a completely new approach. It consists of 19 "items," general topics really, which the adviser is required to address in a narrative format. And not only are narrative answers required, but they must be written in "plain English." In the SEC's world, "plain English" is a writing style adopted by the agency in the 1990s for use in prospectuses, proxy statements and the like which public companies are required to file. The SEC has some very specific requirements in mind when they refer to plain English – first person narrative ("we," "ours," etc.), short sentences, simple words whenever possible, avoidance of defined terms, avoidance of passive voice, and more. It has become something of an art form for SEC practitioners.

The 19 required headings may not be altered, and all must appear in the document, even if not applicable to a particular adviser. The topics include:

- Business description and identity of owners.

- All aspects of fees and compensation, including identification of potential conflicts of interest if advisers personally receive payments from third parties such as mutual funds or brokers, performance fee arrangements, and referral fees.
- Types of clients.
- Detailed description of investment strategies used and related risks.
- Information about any disciplinary problems the adviser may have had in the past.
- Adviser's relationships with other firms, including affiliated companies.
- Code of Ethics.
- Brokerage practices, including broker-dealer best execution practices and directed brokerage requirements.
- Client account review practices and reporting frequency.

A brochure appendix is required if the adviser participates in any wrap fee programs, and a "brochure supplement" is required for all advisers, providing individualized information about all "supervised persons" who actually provide investment advice or otherwise have direct contact with clients.

Compliance Timing

The new Part 2 rules become effective 60 days after their publication, in the Federal Register, around September 21, 2010, applicable the next time after that an adviser is required to update its Part 2. In almost all cases that means Part 2 must be updated *and filed with the SEC via IARD* by March 31, 2011. It is not too early to start working on your new Part 2!